Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Hancock	Analyst:	Jennifer Bettencourt	Bill Number:	AB 2897
Related Bills:	See Legislative History	Telephone:	845-5163	Introduced Date:	February 22, 2008
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: PIT Rates/Increase Maximum Rates To 10% & 11% & AMT Rate To 8.5% Beginning On Or After January 1, 2008

SUMMARY

This bill would reestablish personal income tax (PIT) rates of 10% and 11% and would increase the alternative minimum tax (AMT) rate for PIT taxpayers to 8.5%.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to protect funding for education by increasing general fund revenues.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective upon enactment and operative for taxable years beginning on or after January 1, 2008.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Federal law imposes six different income tax rates on individuals, estates, and trusts ranging from 10% to 35%. Existing state law imposes six different PIT rates ranging from 1% to 9.3%. Each tax rate applies to a different level of income known as a "tax bracket." Existing state law requires the Franchise Tax Board (FTB) to recalculate the tax brackets each year based on the change in the California Consumer Price Index (CCPI).

For taxable years beginning on or after January 1, 1991, and before January 1, 1996, state law included PIT rates of 10% and 11% for taxable income in excess of $100,000 and $200,000, respectively. Higher thresholds were applicable for a taxpayer using the head of household filing status. These tax bracket amounts were also indexed for inflation.

Board Position:			Department Director	Date
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For taxable years beginning on or after January 1, 2005, state law imposes an additional 1% Mental Health Tax (MHT), not subject to reduction by credits, on the portion of a PIT taxpayer's taxable income that exceeds $1 million. The taxable income threshold of $1 million is not indexed based on changes in the CCPI. The MHT is subject to estimated tax payment requirements, interest, penalty, and other tax administration rules.

Federal law provides an AMT rate of 26% on alternative minimum taxable income up to $175,000 and 28% on AMT taxable income exceeding that amount for PIT taxpayers. Existing state law provides an AMT rate of 7% under the PIT law. A taxpayer with substantial income can use preferential tax benefits, such as exclusions, deductions, and credits, to reduce their income tax liability. AMT was established to ensure that a taxpayer who can use preferential tax benefits does not completely escape taxation.

<u>THIS BILL</u>

This bill would reestablish a PIT rate of 10% for the following:

- Single filers (including married/Registered Domestic Partners (RDPs) filing separate, trusts, and estates) whose taxable income is over $158,838 and equal to or less than $317,676,
- Joint filers whose taxable income is over $317,676 and equal to or less than $635,352, and
- Head of household filers whose taxable income is over $215,345 and equal to or less than $430,690.

This bill would reestablish a PIT rate of 11% for the following:

- Single filers (including married/RDPs filing separate, trusts, and estates) whose taxable income is over $317,676,
- Joint filers whose taxable income is over $635,352, and
- Head of household filers whose taxable income is over $430,690.

Combined with the existing additional 1% MHT, this bill would establish a PIT rate of 12% for taxpayers with income greater than $1 million.

Below is an example of the tax brackets and rates for single filers under current California law for 2007 and estimated for 2008:

Actual 2007 Tax Brackets And Rates For Single Filers

$0	-	$6,827	1.0%
$6,827	-	$16,185	2.0%
$16,185	-	$25,544	4.0%
$25,544	-	$35,460	6.0%
$35,460	-	$44,814	8.0%
$44,814	-	And Over	9.3%

2008 Estimated Tax Brackets And Rates For Single Filers As Proposed

$0	-	$6,976	1.0%
$6,976	-	$16,537	2.0%
$16,537	-	$25,100	4.0%
$26,100	-	$36,232	6.0%
$36,232	-	$45,789	8.0%
$45,789	-	$150,046	9.3%
$150,046	-	$300,087	10%
$300,087	-	And over	11%

This bill provides that the 10% and 11% brackets would be adjusted annually for inflation.

This bill would also increase the AMT rate from 7% to 8.5% for PIT taxpayers.

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.

LEGISLATIVE HISTORY

AB 2372 (Coto, 2008) would impose an additional 1% tax on taxable income in excess of $1 million for the College Affordability Fund. This tax, combined with the existing MHT, would effectively create an 11.3% tax rate for PIT taxpayers with taxable income in excess of $1 million. AB 2372 is currently with the Assembly Revenue and Taxation Committee.

AB 6 (Chan, 2005) contained language similar to the language of this bill, but also would have reduced the amount of tax paid under the increased tax rates by the amount of tax imposed under Proposition 63, the MHT. AB 6 failed to pass out of the house of origin by the constitutional deadline.

Proposition 63 (Steinberg), approved by voters in the November, 2004, General Election, imposes a 1% tax on taxable incomes in excess of $1 million to provide a dedicated funding source for the expansion of mental health treatment options for children, adults, and seniors.

AB 1403 (Coto, 2005), AB 4 (Chan, 2003), and SB 1255 (Burton, 2002) contained language similar to the language of this bill. AB 1403 failed to pass the Assembly Revenue and Taxation Committee; AB 4 and SB 1255 failed to pass out of the house of origin by the constitutional deadline.

SB 169 (Alquist, Stats. 1991, Ch. 117) increased the tax rates on individuals for taxable years beginning on or after January 1, 1991, and before January 1, 1996, by adding 10% and 11% brackets and increasing the AMT rate from 7% to 8.5%.

PROGRAM BACKGROUND

In the early 1990s, California faced a severe recession, which resulted in significant shortfalls in the state budget. In response, the state acted to increase revenues and reduce expenditures. As one way of increasing revenues, the state imposed a temporary income tax rate increase[1] in 1991, adding 10% and 11% rates for the highest income taxpayers. This temporary tax increase was in effect for four taxable years and sunset for taxable years beginning on or after January 1, 1996.

OTHER STATES' INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota,* and *New York.* These states were selected due to their similarities to California's economy, business entity types, and tax laws.

Florida does not have a personal income tax. *Illinois, Massachusetts,* and *Michigan* impose a flat tax of 3%, 5.3%, and 3.9% respectively. *Minnesota* and *New York* have a progressive rate[2]. *Minnesota* has a maximum tax bracket of $69,991 for single and $123,751 for joint filers, with a maximum tax rate of 7.85%. *New York* has a maximum tax bracket of $20,000 for single and $40,000 for joint filers, with a maximum tax rate of 6.85%.

These amounts and rates apply to returns filed in 2008 for the 2007 taxable year.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

[1] SB 169 (Alquist, Stats. 1991, Ch. 117)
[2] Progressive tax rate is when each tax rate applies to a different level of income known as a "tax bracket."

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue gains:

Estimated Revenue Impact of AB 2897 Effective On or After January 1, 2008 Enactment Assumed After June 30, 2008 ($ in Billions)			
	2008-09	2009-10	2010-11
Re-instate 10% & 11% Tax Brackets	+$6.3	+$4.8	+$5.0

This estimate does not consider the possible changes in employment, personal income, or gross state product that could result from this bill.

Revenue Discussion

The revenue impact of this bill is determined by the number of taxpayers subject to the 10% and 11% tax brackets. The estimate takes into account the effect of the MHT.

The above estimates are based on the department's personal income tax model, beginning with the 2008 taxable year and are estimated to impact approximately 576,000 taxpayers.

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